



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

NO PROTEST RECEIVED
DEPARTMENT OF THE TREASURY to Manager, EO Determinations - Cincinnati
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

DATE: [REDACTED]
SURNAMES: [REDACTED]

Date: [REDACTED]

Contact Person: [REDACTED]

Identification Number: [REDACTED]

Contact Number: [REDACTED]

Employer Identification Number: [REDACTED]

RECEIVED
Centralized Files Unit

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(6). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

Facts:

The information submitted indicates that you were incorporated on [REDACTED] as a nonstock corporation under [REDACTED] law for the purpose of "engag[ing] in any lawful act or activity which may be carried on by a nonstock corporation under the laws of the State of [REDACTED]"

In your application, you describe yourself as "an association of [REDACTED] the purpose of which is to promote the common interests of [REDACTED] generally."

Your Certificate of Incorporation provides for "one class of members, who shall be known as [REDACTED], and who shall meet the eligibility and admission requirements set forth in the Bylaws."

Section 1.01 of the Bylaws provides that there shall be one class of members, who shall be known as [REDACTED], and who shall have the right to vote, receive distributions upon dissolution, and otherwise possess all proprietary interest in the Taxpayer. There is no limit to the number of [REDACTED] Taxpayer may also have patrons who participate in programs offered by the Taxpayer, or use its services, but are not Corporators and shall be designated [REDACTED] [REDACTED] have no right to vote nor any right to distributions, or other proprietary rights.

Section 1.02 of the bylaws provides that any person is eligible to become a [REDACTED] or [REDACTED] provided it owns and operates a retail store which sells [REDACTED] and other goods and

[REDACTED]

To date, the Organization has devoted its time and resources principally to the development of the arrangements with vendors described above [REDACTED] and to the creation of software solutions that enable [REDACTED] to operate more efficiently and meet the growing demand of their [REDACTED] constituencies for digital services [REDACTED].

You describe your present and future sources of financial support as follows:

By far the largest source of financial support for the Organization to date has been signing fees paid to the Organization by [REDACTED] under a [REDACTED]. [REDACTED] is in the business of buying and selling used [REDACTED]. The [REDACTED] is designed to provide [REDACTED] with an expanded market for its used [REDACTED] business and afford participating [REDACTED] with purchasing and operational efficiencies through the application of technology and other cost-effective solutions. Similar but lesser up-front payments have been received by the Organization under agreements with [REDACTED], a supplier of [REDACTED]. All of these arrangements provide for future payment to the Organization of a small percentage of the business done by these suppliers with participating [REDACTED] but such payments are projected to be relatively modest.

[REDACTED] is a for-profit [REDACTED]

[REDACTED] is a for-profit wholesale distributor of [REDACTED]
[REDACTED] is a for-profit wholesaler of [REDACTED]

In describing how these partnership arrangements with vendors promote the interest of [REDACTED], you state:

For several years now the industry has been consolidating on both the store and supplier side. On the [REDACTED], the two biggest blocks are chain or contract-managed stores and independent stores. The chain stores, as a result of their volume, have been successful in obtaining better terms and conditions from suppliers than the independent stores. The [REDACTED] has organized an alliance of independent [REDACTED] to approach suppliers with a win-win proposition of taking costs out of the supply chain and sharing in those savings, thereby reducing costs to the stores and, in the long run, the [REDACTED].

The arrangements all have four basic elements: (1) they commit the store to an annual or multi-year agreement; (2) they commit the store to a "prime source" position, so that the supplier will receive the orders first, (3) they commit the supplier to a variety of better terms and conditions, that may include initial costs, freight, returns incentives, etc. ... and (4) both the [REDACTED] and the suppliers commit to co-development of the software [REDACTED]

[REDACTED]
necessary to automate as much of the process as possible, centered around a robust [REDACTED]

The programs that are currently completed or under development are: (1) [REDACTED]; (2) [REDACTED]; and (3) [REDACTED]

You have entered into an agreement with [REDACTED] to provide [REDACTED] users and your members will initially qualify to participate. Your [REDACTED] with [REDACTED] will provide a "software development advance" to develop applications that conform to [REDACTED] will pay you a full [REDACTED]% on the cumulative net book purchases from [REDACTED] by your member stores that have signed a subscription agreement with [REDACTED]. Not all member stores will be mandated to enlist in the program, however you agree to endorse this program in the market in appropriate ways.

The subscription agreement between [REDACTED] is a prime source agreement applicable to [REDACTED] required in courses. [REDACTED] stores receive the standard [REDACTED]. On most [REDACTED] this is [REDACTED]%. Participants agree to purchase titles available from [REDACTED] will receive first or prime sourcing. [REDACTED] does not have the [REDACTED] the member store will source it elsewhere.

You have entered into an agreement with [REDACTED]. The objective of the agreement is to provide [REDACTED] with an expanded market for its [REDACTED] business while affording participating member stores purchasing and operational efficiencies. Under the agreement, you will not enter into any other used [REDACTED] prime source agreement. [REDACTED] shall offer the program, by means of subscription agreement, to member stores that are [REDACTED] users. You shall actively market the program among independent [REDACTED] and shall seek the participation of your members in marketing activities on behalf of the program.

[REDACTED] shall pay you signing fees of [REDACTED]% of the "projected annual sales to [REDACTED] of members that subscribe to the programs. "Projected annual sales to [REDACTED] shall mean [REDACTED]% of the average annual sales to all wholesalers by the subscribing member over the [REDACTED] preceding the date of the subscription agreement. Upon renewal of subscription agreements, [REDACTED] shall pay you renewal fees to based upon [REDACTED]% of the renewing member's projected annual sales to [REDACTED]

For all business done by [REDACTED] with members having five-year agreements, you will receive [REDACTED]% of net sales from Follett to participating members stores per year, and for members with three-year agreements, you will receive [REDACTED]% of net sales from [REDACTED] to [REDACTED] stores per year. You will also receive [REDACTED]% of purchases by [REDACTED] from all participating stores per year.

The subscription agreement between [REDACTED] and member stores provides that the subscriber shall utilize [REDACTED] as its prime source of supply for used [REDACTED]

Subscriber will also sell to [REDACTED] an agreed-upon percentage of [REDACTED] (not less than [REDACTED]%) that are sold by subscriber to wholesalers. In addition, subscriber shall be a member of [REDACTED].

The [REDACTED] web site linking agreement provides that a participating [REDACTED] agrees to support a fully developed link between the [REDACTED] web site and [REDACTED].

You have entered into an agreement with [REDACTED] concerning the payment of a sales incentive to you based on the [REDACTED] sales by [REDACTED] to [REDACTED] stores. Under the agreement [REDACTED] shall pay you a sales incentive of [REDACTED]% on [REDACTED] based net annual sales from member stores that are enrolled in the program. You agree to endorse [REDACTED] as the exclusive wholesale business tool for [REDACTED] in supplying their general [REDACTED]. You will actively market [REDACTED] to member stores, prospective members, and the [REDACTED] industry as a program that effectively reduces a [REDACTED] cost of business.

On account of the payments you receive through these [REDACTED], you do not assess dues to your members.

In addition to negotiating and administering agreements with [REDACTED] on behalf of your members, you and your members are engaged in "the creation of [REDACTED] that enable [REDACTED] to operate more efficiently." Since your original Corporators all use [REDACTED] you will promote the development of the [REDACTED]. You will purchase software design services from member stores as well as from [REDACTED]. You explain the software design process as follows:

The application software is designed to enable the use of faster, better, and less costly processes. The software will initially be written as a component of the [REDACTED] an application software program for [REDACTED]. However, we will also plan to work with [REDACTED] that do not use [REDACTED] to help encourage those stores' system providers to provide analogous capabilities. The software will be created by a combination of staff at the [REDACTED] by contracted programmers, and by staff at [REDACTED].

Software will be made available to the industry in a two-step manner. First we will integrate the software into the [REDACTED] and distribute it to all [REDACTED]. Almost all of our current members are [REDACTED]. The next step will be to work with members who use other systems to have those application programs adopt the protocols and/or capabilities of the [REDACTED].

Basically ... the software [is] written wherever it makes the most sense. In some cases, writing the software from within the user environment makes more sense and in those cases we have it written at the store. However, the

[REDACTED]

store must agree to use the [REDACTED]
the programs so that integration will be as seamless as possible.

At your web site, potential members are encouraged to contact one of your board members who "will be glad to assist you in determining whether the goals of the [REDACTED] [REDACTED]." The [REDACTED] found in the Prospect Information area of your web site describes your "Strategy," -- i.e., "To build a principle centered virtual chain" -- as follows:

[REDACTED] means we must have "Size" -- multiple, large stores. We must act like a [REDACTED] by negotiating programs that scale to multiple stores and then participate in those programs. We will focus on large [REDACTED] to give us both size and compatibility of systems, and then modify programs appropriately for others.

While the first step is to derive benefit from acting in unison to negotiate and implement targeted channel re-engineering initiatives, the second will be to broaden our activities. ... Here are some examples:

1. Expand prime source relationships to many major suppliers.
2. Build a comprehensive customer profiling system to support increasingly customized interactions with suppliers.
3. Create a common web strategy & investment infrastructure.
4. Build a scaleable "branded marketing" program.
5. Expand collaborative buying.

Terms of Membership-- In a word, it is "participation." To be successful, we must negotiate the partnership relationships as though we were already a disciplined chain. Then we must move promptly to implement these programs. While no one will be expected to participate in every program, substantial participation is essential in achieving the goals outlined above and to maintaining one's membership in the [REDACTED]

Law:

Section 501(c)(6) of the Code exempts from federal income taxation business leagues and chambers of commerce not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(6)-1 of the Income Tax Regulations provides that a business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. It is an organization of the same general class as a chamber of commerce or board of trade. Thus, its activities should be directed to the improvement of the business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons. An organization whose purpose is to engage in a regular business of a kind ordinarily carried on for profit, even though the business is conducted on a

cooperative basis or produces only sufficient income to be self-sustaining, is not a business league.

Rev. Rul. 58-294, 1958-1 C.B. 244, holds that an association of licensed dealers in a certain type of patented product does not qualify as a business league under section 501(c)(6) of the Code where the association owns the controlling interest in a corporation holding the basic patent, is engaged mainly in furthering the business interests of its member-dealers, and does not benefit people who manufacture competing products of the same type covered by the patent.

Rev. Rul. 66-338, 1966-2 C.B. 226, holds that an organization formed to promote the interests of a particular retail trade which advises its members in the operation of their individual businesses and sells supplies and equipment to them is not exempt under section 501(c)(6) of the Code. Such activities provide the members of the organization with an economy and convenience in the conduct of their individual businesses by enabling them to secure supplies, equipment, and services more cheaply than if they had to secure them on an individual basis. Therefore, these activities constitute the performance of particular services for individual persons as distinguished from activities aimed at the improvement of business conditions in their trade as a whole.

Rev. Rul. 68-182, 1968-1 C.B. 263, holds that organizations promoting a single brand or product within a line of business do not qualify for exemption under section 501(c)(6) of the Code.

Rev. Rul. 73-411, 1973-2 C.B. 180, holds that a shopping center merchants' association whose membership is restricted to and required of the tenants of a one-owner shopping center and their common lessor, and whose activities are directed to promoting the general business interests of its members, does not qualify as a business league or chamber of commerce under section 501(c)(6) of the Code. The revenue ruling finds that a necessary characteristic of a chamber of commerce is that membership be voluntary and open generally to all business and professional people in the community. Trade associations or business leagues are similar to chambers of commerce except that they serve only the common business interests of the members of a single line of business or the members of closely related lines of business within a single industry. Since membership in the shopping center merchants' association is not voluntary in the sense that its members are free to join or not to join depending on their interests as members of a business community, but is compulsory and is imposed by the landlord owner of the shopping center, the organization lacks the essential element of public representation with respect to its membership and the "community" it purportedly serves which is characteristic of organizations commonly accepted as being chambers of commerce or similar organizations.

Rev. Rul. 83-164, 1983-2 C.B. 95, describes an organization whose purpose is to conduct conferences for the dissemination of information concerning computers manufactured by one specific company, M. Although membership is comprised of various businesses that own, rent, or lease computers made by M, membership is open to businesses that use other brands of computers. At the conferences, presentations are given primarily by representatives of M, as well as by other experts in the computer field. Problems related to members' use of M's

computers are also discussed and current information concerning M's products are also provided. The revenue ruling holds that by directing its activities to businesses that use computers made by one manufacturer, the organization is improving business conditions in a segment of a line of business rather than in an industry as a whole and is not exempt under section 501(c)(6) of the Code. The revenue ruling concludes that by providing a focus on the products of one particular manufacturer, the organization is providing M with a competitive advantage at the expense of manufacturers of other computer brands.

In National Muffler Dealers Assn., Inc. v. United States, 440 U.S. 472 (1979), the Supreme Court addressed the issue of whether the Petitioner, a trade organization for muffler dealers, is a "business league" entitled to exemption under section 501(c)(6) of the Code. Petitioner confines its membership to dealers franchised by Midas International Corporation. Its principal activity is to serve as a bargaining agent for its members in dealing with Midas. The Supreme Court affirmed the decision of the Court of Appeals for the Second Circuit that Petitioner's purpose was too narrow to satisfy the "line of business" requirement of section 1.501(c)(6)-1 of the regulations. The Court of Appeals had concluded that any success the Association might have in improving the business conditions for Midas franchisees would come at the expense of the rest of the muffler industry. The Supreme Court concluded that "the 'line of business' limitation is well grounded in the origin of section 501(c)(6) and in its enforcement over a long period of time. The distinction drawn here, that a tax exemption is not available to aid one group in competition with another within an industry, is but a particular manifestation of an established principle of tax administration."

In National Prime Users Group, Inc. v. United States, 667 F. Supp. 250 (D.C. Md. 1987), the Court held that an organization which served the needs of users of a specific brand of computer promoted only a segment of a line of business and was not exempt under section 501(c)(6) of the Code.

In Guide International Corporation v. United States, 948 F.2d 360 (7th Cir. 1991), the Court held that an association of computer users did not qualify for exemption under section 501(c)(6) of the Code because it benefited essentially users of IBM equipment.

In MIB, Inc. v. Comm'r., 734 F.2d 71 (1st Cir., 1984) rev'g 80 T.C. 438 (1983) the First Circuit agreed that the phrase in the regulations "as distinguished from the performance of particular services for individual persons" is a limitation upon the requirement that a business league's activities be directed to the improvement of business conditions of one or more lines of business. The ultimate inquiry is whether the association's activities advance the members' interests generally, by virtue of their membership in the industry, or whether they assist members in the pursuit of their individual businesses. The court stated that it was unaware of any instance in which an organization that performs discrete services for individual members, and at charges substantially tied to those very services, was recognized as a business league. The court concluded that a business league must not only improve the conditions of a line of business, but also must do so in a way different from simply supplying products or services to members. The court also said that a major factor in determining whether services are "particular" is whether they are supported by fees and assessments in "approximate proportion to the benefits received."

[REDACTED]

In Glass Container Industry Research Corporation v. United States, 70-1 U.S. Tax Cas. (CCH) P9214 (W.D. Pa. 1970) the Court examined an organization that had applied for recognition of exemption under section 501(c)(6) of the Code. The organization conducted scientific research in the field of glass container production and manufacture. Its initial members were six manufacturers of glass containers. Independent commercial research organizations, colleges, and universities performed the actual research. The research contracts provided that the results were not to be disclosed. Members were forbidden to disclose the research reports to nonmembers. Any reports that were made public were not to disclose production information that would be of value to a nonmember. The Court found that glass container manufacturers joined the organization in order to pool their funds to secure the benefit of research through a cooperative effort. The Court concluded that, research being the organization's dominant purpose, and the results of the research being only for the benefit of the members, the organization was simply a cooperative effort on the part of a limited number of persons to research business projects for the benefit of themselves rather than the industry at large. Thus, the entity was not tax-exempt. The Court stated that 30% of a group of manufacturers engaged in an industry cannot organize themselves solely for the purpose of investigating and discovering cheaper and better methods of conducting their business with a view to increasing their profits while restricting the dissemination of the research results and at the same time be tax-exempt under the statute.

Analysis:

Under the facts presented, we conclude that you do not qualify as a business league under section 501(c)(6) of the Code because: (1) you are not membership-supported and membership is not voluntary; (2) your membership does not constitute a "line of business" within the meaning of section 1.501(c)(6)-1 of the regulations; (3) your primary activity consists of performing particular services for your members; and (4) you are engaged in a regular business of a kind ordinarily carried on for profit.

The legislative history and the rules of statutory construction applicable to section 501(c)(6) of the Code provide that only membership organizations supported by membership dues or assessments are entitled to exemption under section 501(c)(6). While a 501(c)(6) organization may receive a substantial portion or even the primary part of its income from non-member sources, membership support, both in the form of dues and involvement in the organization's activities, must be at a meaningful level.

You have members but no membership dues. Your support comes almost exclusively from signing fees, renewal fees, and other fees paid by the commercial wholesalers with whom you've signed "Partnership Agreements."

Like the organization described in Glass Container Industry Research Corporation v. United States, you represent only a small percentage of organizations from your industry, and are engaged primarily in cooperative activities for the benefit of those members only. You have indicated that you will concentrate your efforts on [REDACTED]

[REDACTED] As a condition of membership, a store is expected to substantially participate in the

[REDACTED]

various partnership relationships that you worked out with [REDACTED]

Of your members, only a small number of Corporators possess voting rights, serve on your Board of Directors, and participate actively in determining and developing your activities. A larger group of "patron" Members has no such rights or privileges and merely takes advantage of the cooperative agreements with [REDACTED]. Eligibility to be a Corporator is restricted to "any person [who] owns and operates a retail store which [REDACTED] ... and is located on or near the [REDACTED] and meets any additional qualifications set forth by the Board of Directors. Since you have discretion over whom to admit as a Corporator, your membership is not "voluntary" within the meaning of Rev. Rul. 73-411.

In order to qualify for exemption as a business league under section 501(c)(6) of the Code, an organization must direct its activities to the improvement of business conditions in one or more lines of business. The term "line of business" means either an entire industry or all components of an industry within a geographic area. A business group with a membership or purpose that is narrower does not meet the "line of business" requirement. See National Muffler Dealers Assn., Inc. v. United States.

Although your membership is open to all independent [REDACTED] your [REDACTED] the only members with voting privileges, are all [REDACTED] that use the [REDACTED]. Your membership focus has been on [REDACTED]. You have purchased [REDACTED], a firm that specializes in the development of [REDACTED]. You will contract with [REDACTED] to write software and develop applications using [REDACTED] that will become a component of the [REDACTED]. You will distribute new [REDACTED]

Your activities promote the development and competitive advantage of [REDACTED] over that of competing software systems and, thus, your activities primarily benefit [REDACTED] using the [REDACTED] provide only incidental benefit to those stores that do not use [REDACTED]. Since [REDACTED] constitute only a segment of the [REDACTED], you do not represent a "line of business" within the meaning of section 1.501(c)(6)-1 of the regulations under the reasoning of Rev. Rul. 58-294, Rev. Rul. 68-182, Rev. Rul. 83-164, National Prime Users Group, Inc. v. United States, and Guide International Corporation v. United States.

The performance of particular services by an organization for its members or others is not an exempt activity under section 501(c)(6) of the Code. An organization whose primary activity is performing particular services does not qualify for exemption under section 501(c)(6).

Your primary activity is to negotiate "partnership arrangements" with book publishers, wholesalers, and distributors on behalf of your [REDACTED]. This enables your member stores to "leverage [their] collective size" and "act like a chain by negotiating programs that scale to multiple stores." The purpose of such programs is to expand the market of participating book wholesalers while "affording participating [REDACTED] with purchasing and operational efficiencies. However, non-participating member stores and non-member [REDACTED] derive no such benefits. Thus, your activities principally benefit you member stores in the pursuit of their

[REDACTED]

individual businesses as opposed to benefitting the [REDACTED] industry generally. Since you do not assess member dues, you are largely supported by fees from [REDACTED] in direct proportion to the benefit they receive from member stores. Consequently, you are performing particular services for members under the reasoning of Rev. Rul. 66-338 and MIB, Inc. v. Comm'r.

Finally, your primary activities -- the negotiation of business agreements with for-profit book wholesalers and the development and marketing of a commercial software product -- show you to be engaged in a regular business of a kind ordinarily carried on for profit. Under the regulations, an organization having such a purpose is not a business league.

Conclusion:

Accordingly, you do not qualify for exemption as an organization described in section 501(c)(6) of the Code and you must file federal income tax returns.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views to this office, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If we do not hear from you within 30 days, this ruling will become final and a copy will be forwarded to the Ohio Tax Exempt and Government Entities (TE/GE) office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201.

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Internal Revenue Service
[REDACTED]
[REDACTED]
[REDACTED]

Sincerely,

[REDACTED]

CC

[REDACTED]

[REDACTED]